RICHARD RUSSELL'S **DOW THEORY LETTERS, INC.**

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September 23, 1981 **LETTER 818**

Sept. 11, DJIA 872.81; PTI 1448; A-D Ratio –22.53
Sept. 18, DJIA 836.19; PTI 1412; A-D Ratio –23.87

THE PICTURE: During 1980 gold and silver crashed. During the same period and throughout 1981 the bond market suffered its worst smash in modern history. In 1981 commodities collapsed across the board. More recently the price of homes has softened while the entire real estate picture has turned illiquid. Now the stock market is locked into a primary bear trend. I study my charts and my statistics, and I wonder, "How long will it be before these massive losses are reflected in the economy?" My guess is that we'll see it by the end of the year.

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I don't know what it is about this bear market, but from what I gather from letters and calls to this office a lot of people have chosen not to sell their stocks. Many of these optimistic individuals are new subscribers or recent subscribers, and they have probably never lived through a major bear market.

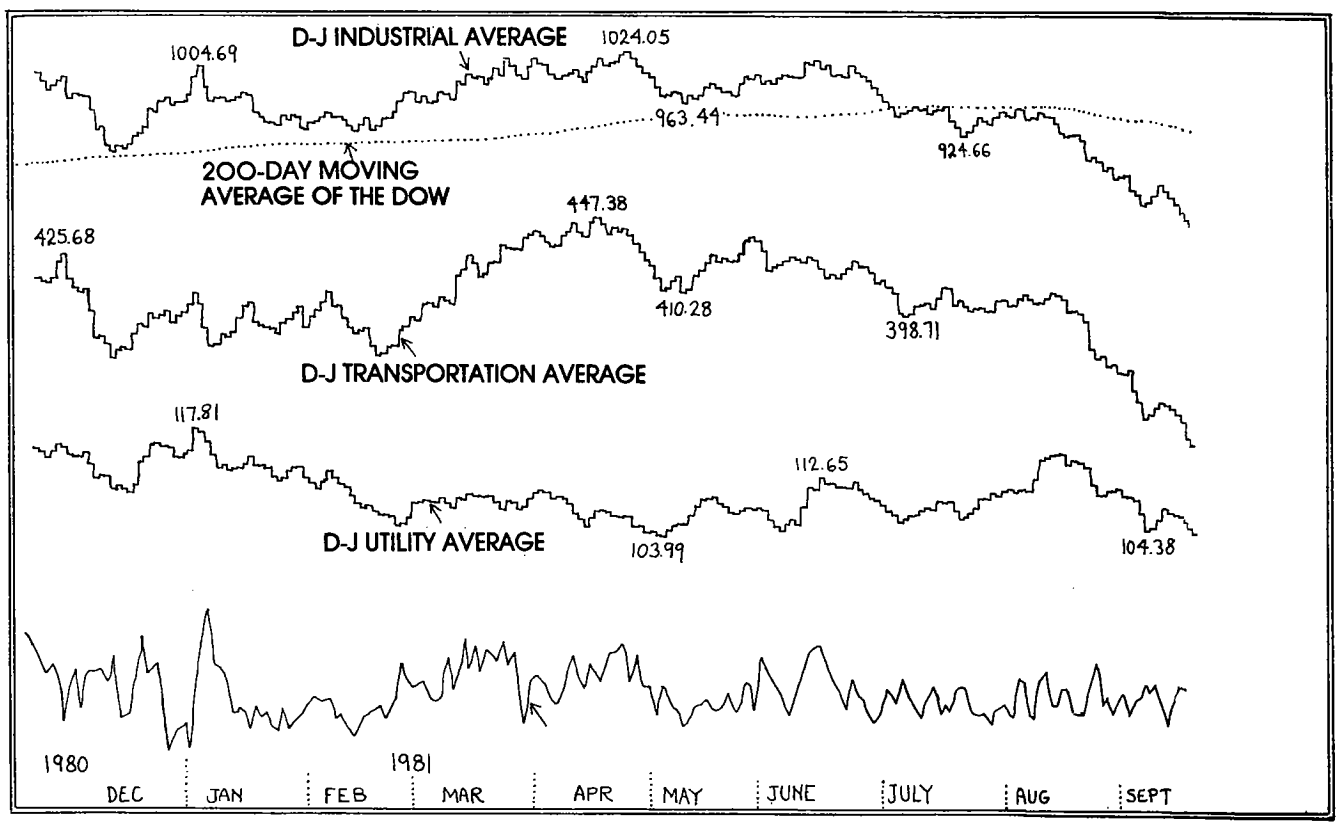
"Major bear market?" you retort, "who says it's going to be a major bear market?" And that's where *correct procedure* comes in. One of the things I have always advocated in these reports is that my subscribers follow correct procedure. Correct procedure dictates that we buy 'em in a primary bull market. And we get on the sidelines during a primary bear market. How much do we buy in a bull market? How much do we sell during a bear market? My answer is that you buy as much as you can sleep with when the bull takes over. And you get as liquid as you can during a primary bear market.

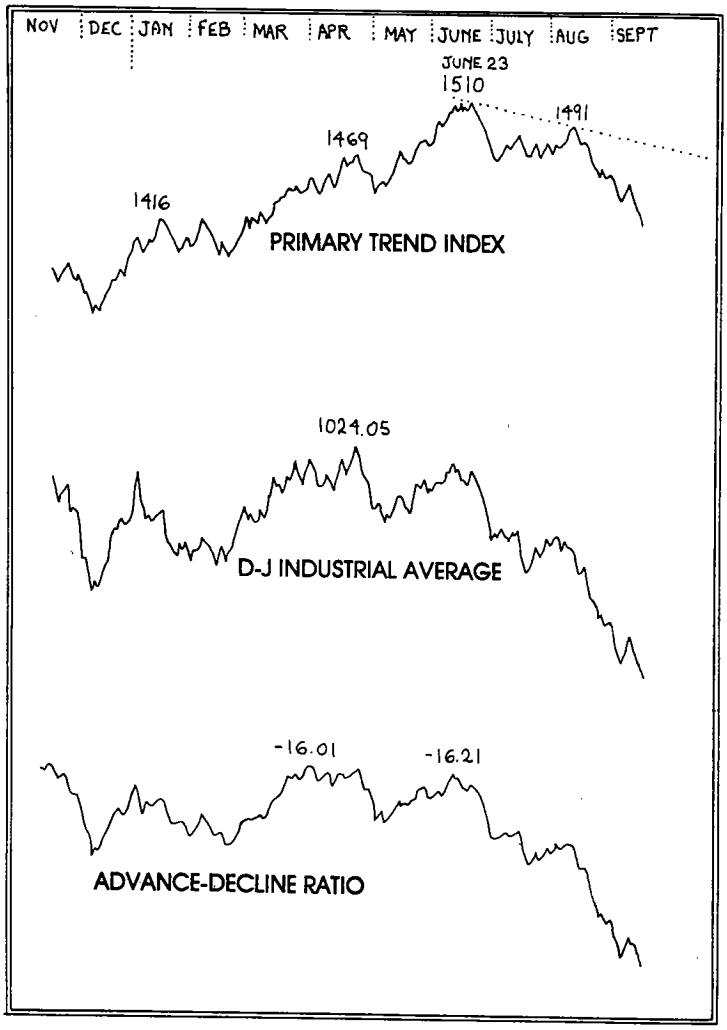
As to whether it's going to be a major bear market or not, there's not a man or woman or group on the face of the earth who can

FRONT PAGE COMMENT: I really don't believe that Washington or President Reagan fully comprehend the seriousness of the financial problems that have enveloped this nation. The number one problem is too much debt (debt that is still rising) and an inability to service that debt. They call it illiquidity. And I don't know if Reagan or Washington have the will or the ability to deal with the problem before it bursts over our heads like a Roman Candle.

The tax cuts of '81 sailed through Congress quickly – that was the easy part. Now comes the hard part, really cutting the budget. Last week the President opted for a mini-token cut of 2% in the military over the next three years (actually it was a cut in the increase in military spending). To which I say, "Forget it." That 2% will be lost within a year through price increases. The President also ruled out Social Security cuts. That means the Administration will have to cut around $90 to $100 billion from the civilain budget over the next three years. Wall Street, to put it mildly, is skeptical.

From here on special interests in Congress will fight every cut tooth and nail. If I were President, I'd cut every Government department and agency 15% – right across the board, but that won't happen either. In the meantime, the markets are watching the whole show with dismay. Only one thing will really satisfy the markets: Eliminating deficits and balancing the budget.





guarantee that it won't be a major bear market. Which is why we follow correct procedure and sell out when the Dow Theory and the Primary Trend Index turn bearish. In my experience, there's no greater agony than paying for advice, being told it's a bear market, ignoring that advice and then watching your hard-earned assets go down the drain. Conversely, there's no better feeling than following an advisor, understanding the logic of his advice, getting out on a bear market call, and preserving your capital while the market goes to hell in a handbasket.

Don't get me wrong, I don't like primary bear markets, and I never gloat over another man's misfortunes. But God gave us brains to think with and strength to act with, and if we think right and act right we are also staying *in harmony* with the great unseen forces of the market. Avoidance of bear markets comes under the same heading as getting out of the building when the fire starts or getting off the tracks when the Silver Chief blows its whistle. Of course we hope the firemen can control the blaze and we hope the train is coming down on the other track, but brother – don't stake your life on it!

The Averages continue to perform in near-perfect bear market fashion, working their way lower amid protests of "the market's oversold" or "the bottom is just around the corner." The bear was held back during late-1980 and most of 1981, so he has work to do and a lot of downside action to express.

Since the PTI high (1510) of June 23, there have been 19 days on the NYSE during which there were 1000 or more declines. There will doubtless be many more such days. To compare, the PTI recorded a bull market high of 1072 on April 12, 1972. During 1972 there were 12 days of 1000 declines or more. During 1973 (as the bear market continued) there were 52 days of 1000 or more declines. And during 1974 there were 48 days of 1000 or more declines.

One of the big problems during a primary bear market is that people get impatient and they jump the gun. They don't allow the bear to express himself in his own way. This causes premature buying, confused in-and-out trading, and inevitably – losses. This is the reason that I repeat over and over again, "Sit back, relax, let the bear do his work, stop trying to outwit the bear."

On the chart (at left) we see that the PTI is now firmly fixed in its bear trend. And, in fact, the PTI is now tending to lead the market down (it frequently drops to new lows ahead of the Dow). At the same time, the A-D ratio (which is a proxy for ALL stocks on the NYSE) has sunk to its lowest level since May, 1980, which means that 16 months of market action on the NYSE has now been wiped out.

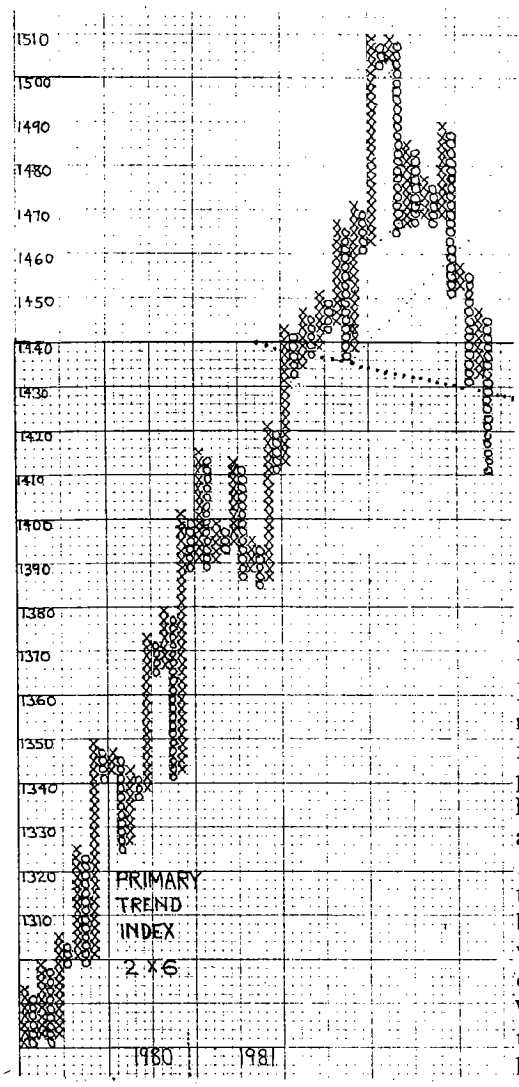
Many financial cretins are blaming the Reagan Administration for today's tumbling markets. But in Letters written during late-1980 and 1981 I drew repeated attention to the shocking divergences which had developed in the Dow and A-D ratio, and the Dow and its own A-D line. These divergences were technical evidence that the stock market was sick and getting sicker. In fact, I wrote that the divergences in the Dow and the various breadth measurements were the worst I had ever seen. Therefore, it should come as no surprise to readers of these Letters that the stock market is now having a heart attack. The message was there for all (who were willing) to see.

PRIMARY TREND INDEX: The point & figure chart of the PTI (page 3) may be the most important stock market chart in existence today. Why? Because at this time it is telling a very definite and frightening story. It's a story that is seen nowhere else but in these Letters. For the benefit of new subscribers, I'll repeat that the PTI is my own proprietary indicator. It is an amalgam of eight critical averages and indicators, and it is computed daily. As those who have been with me for a few years or longer can attest to, the PTI is a most potent weapon in our battle to survive (or perhaps even profit) in the 1980's.

All during 1981 I drew attention to the rising trendline in the PTI and to the fact that the PTI was holding above that trendline. I stated repeatedly that no major decline was possible until the PTI entered a declining trend. On June 23 the PTI recorded a high of 1510 and then turned down. On August 21 the long rising trendline was broken. The market since then has been in shambles, and we now have a new picture on the PTI. The PTI is in a definite bear trend. Consequently, a declining trendline from the June 23 peak has been drawn.

There is another very interesting facet to the PTI picture. I keep a number of different charts of the PTI (moving averages, point & figure, weekly bar charts). I am including my 2 x 6 chart of the PTI. The 2 x 6 means that each box on the chart equals 2 points on the PTI and only reversals (rallies or declines) of 6 points or more are entered.

What we see on the chart is a major top in the PTI, a top that has assumed the form of an ominous head-and-shoulders pattern. The low of 1432 was touched on September 8, a rally occurred which formed a right shoulder in the pattern. On September 16 the PTI broke to 1426, thereby shattering the "neckline" or resistance line. Although pull-backs and rallies may occur, I consider this



top to be of sufficient size to take the PTI considerably lower – to an ultimate major oversold situation for the market.

Question: Russell, you mean to say that after all this downside action, that instead of being near a bottom, the stock market could now be simply extending its decline?

Answer: Despite the fact that the Dow has lost almost 200 points from its high, the pattern of the PTI suggests that all the action of 1981 (right up to the September 16 break on the PTI) was simply part of a major TOP. With the violation of the 1432 level on September 16, the head-and-shoulders top in the PTI is completed. My minimum "count" or projection on the basis of the P&F chart is for the PTI to decline to 1378. But a primary movement often takes the projection far past the original count.

One thing I am watching for is signs of liquidation of the huge margin account on the NYSE (which is currently near $14 billion). Already we know that this account dropped $600 million in the latest month. I would expect considerably more pressure to build up as stockholders on margin are slaughtered by the bear.

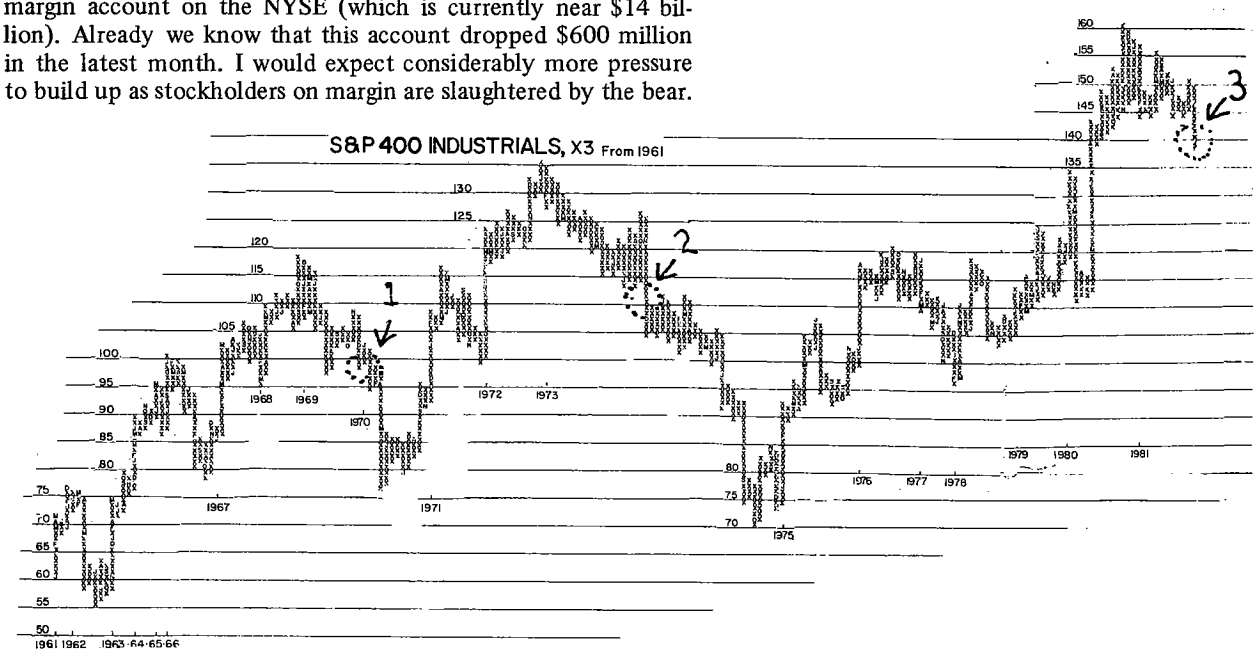
CRITICAL CHART: History doesn't always repeat in the exact same way – but you ignore history at your peril. At the bottom of this page a very long term point & figure chart of the S&P 400 going back 20 years to 1961. There are three MAJOR tops depicted onthis chart, the tops of 1968-69, the top of 1972-73, and the top of 1980-81. I have drawn a dotted circle around the final breaking point on each top.

Note that following breaking point 1 in 1970 there was a bad spill to the final 1970 bottom. Following break point 2 in 1973 there was a horrendous collapse to the final 1974 bottom.

Break point 3 here in 1981 completed, and many analysts and observers are confidently predicting that we have seen the bottom or that the bottom is close at hand. This may, of course, be true. But as I've said many times, this is a major top every bit as big as the two shown on this 20-year chart. If, after the breaking point has passed, the market only sags for a few weeks or so prior to the bottom, I will be very surprised. Based on my experience with major tops, I would guess that the bad part of this bear market lies ahead. At least this study of point & figure action suggests that the bear forces have not yet had their full expression. (P&F chart courtesy of *Market Charts*, 57 W. 57 St., NY, NY 10019).

INVESTMENT POSITION: With the PTI coming down off the right shoulder of its ominous head-and-shoulders top, I have put the bear up on its hind legs. His right paw is raised in defiance, and he's snarling. The bear is working up a big anger, and I don't want my subscribers to fool with him. Of course he could simmer down a bit, he could do anything. But my guess is that he's mighty ornery and he means to go on a rampage. Let's give him a wide berth!

We avoid bruin by staying basically in 91-day Treasury bills with small positions in gold. That's a simple enough position to hold, but sometimes the simplest things are the hardest to do. With inflation around 10% and stocks in shambles and T-bills paying 14-15%, what's so hard about holding T-bills? Yeah, right, it's profitable but not exciting enough (it's much more exciting to lose your shirt holding stocks in a bear market).



STAYING POWER: One of the phenomena that has always fascinated me is what I term *staying power.* Staying power is the ability to survive and function successfully at a given endeavor, whether that endeavor is finance, writing a market letter, running your own business, politics, soldiering, or anything else.

In the investment advisory business, I've seen bright young meteors who make one good call, light up the sky for a few months or so, and then disappear. I've seen others who catch a one or two-year trend, hype their success to the sky, hang on for maybe 2 or 3 years – and then fade away. And I've seen a few services that are pretty good; they make it through 6 to 8 years, but then they seem to lose interest, and the inevitable happens. They close the door.

But the ones that interest me are the ones with the ability and know-how to survive the decades. There aren't many of them. There's Jimmy Dines, there's Joe Granville (both of them since 1961), there's Harry Schultz (since the early '60's), and now that I think of it there's Russell (I started this series back in 1958).

Staying power in the investment advisory business involves a number of things. It involves (1) humility and the ability to grow and learn, (2) the ability to attract a serious professional readership, (3) the ability to communicate in an interesting way, (4) the ability to provide helpful and even vital advice, (5) last and very important, staying power involves an intense and enduring interest in your given profession (if you lose interest, your readers will spot it in a minute).

The stayers that I know (in all fields) are totally engrossed in their work. When I had dinner with Joe Granville a few months ago his eyes lit up as we talked about the stock market. Jim Dines and Harry Schultz will go on all night about the markets. I've spent time with gardeners (nurserymen) who will chew your ears off on their latest creation. And I know politicians who will talk you into the ground about their views of the nation. They're all professionals and the test of staying power is time. If you can survive 20 years (sports excepted) or longer in one field you have (by the Russell test) what I term staying power. And that in itself is fairly rare.

Staying power, by the way, also applies very much to investing. Few people in this world do well financially by mistake. There are plenty of investors who have staying power. Those that have it are usually learners, they are usually humble, and they are very often quite rich.

NOTES & QUOTES: In the investment advisory business, there's only one thing worse than a bear market. And that's a bear market that you missed – one that you never called. Happily (or luckily), I did catch this monster, and business has consequently swelled in recent weeks. To all our new subscribers, I want to say, "Welcome and thank you." A subscriber called and said (kidding, of course) "Russell, you put me in T-bills and the market's going South. What do I need you for now?" I told him, "Read me today for literature and philosophy. But when the bear breathes his last you may need me again, so why not stick around?" Why not . . . . .

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The "energy crisis" of 1979-80 has taken a new form. The crisis now is where to put all the blasted oil! It's piled up in refineries, on tankers, in storage tanks, in capped wells. The world is choking on oil. In fact, there is a possibility that OPEC will fall apart, and Sheik Yamani recently warned of oil at below $30 a barrel. Interesting statistic: in the first 7 months of 1981 gas consumption was 15% below that of 1978 in the US.

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Tom Holt (*Holt Advisory*, 290 Post Rd., West, Westport, CT 06880) correctly points out in his latest report that although the Federal debt situation is bad, the private debt situation is much worse. The Federal debt is approaching $1 trillion, but total private debt is well over $4 trillion. Furthermore, private debt is accelerating faster than government debt. Holt estimates that whereas the Treasury needs to raise about $100 billion a year just to service (pay the interest on) its debt, the private sector must raise near half a trillion dollars a year to service its debt. And this onerous load is accelerating.

Worse (as I've been warning all along), any recession will sharply curtail profits and the ability of the private sector to service its debt. This will result in a panic for money (money with which to stave off bankruptcy). When this happens (along with shortfalls in Government taxes), we will see what I've warned about for over two years – a massive interest rate spike.

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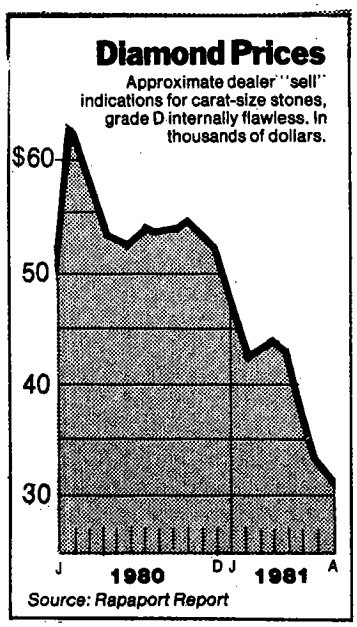
Diamonds and precious stones have been sold aggressively to the public over the past few years. Now the piper is being paid. Diamond prices have suffered a shocking drop of more than 50% since early 1980, and precious stones have eased in tandem. All this has come in the face of major cutbacks in diamond sales on the part of *DeBeers*, the major producer and wholesaler in the diamond world.



Bear market casualties: two major over-the-counter firms have now gone under. First *John Muir* and last week *M.S. Wien.* Why did they go belly up? For one thing, they make markets in the stocks they like, and when you make markets, you own inventory. During a bear market, that inventory can sink you. In these cases, it did sink them.

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With the Reagan budget crisis in full bloom, the President is thinking of asking Congress to restore the right of impoundment. Under this right, the President could decline to spend money appropriated by Congress. This right was taken away from the Presidency under Nixon. Impoundment would allow the President to do a lot of politically embarrassing work that Congress would like to avoid – namely cutting spending.

* *

I'm only taking one trip this year, and it's going to be to New Orleans to speak at the big *8th Annual Investment Conference*

(November 18-22). This is the king of all investment seminars, and Jim Blanchard really puts on a show here. A list of speakers runs on and on, but a few are as follows: Paul Erdman, "Adam Smith," Harry (down from the Alps) Browne, Douglas "Crisis-man" Casey (whose crisis may now be happening), Howard "I'm safe in Utah" Ruff, Jim Sinclair, Jerome Smith, a rare appearance by Ayn Rand, Tom Holt, Marty (he's having a second baby) Zweig, Monte Guild, Martin Weiss, and Louis Rukeyser and his panel of "experts" including all kinds of exotic names, among them yours truly.

It all happens in "food city" which is my nickname for New Orleans, the home of the serious eaters. Whenever anybody in New Orleans thinks about jogging, he just sits down at a table and eats until the jogging urge passes away (is this why the Saints never get to the Super Bowl?) At any rate, for more info write NCMR, 4425 W. Napolean Ave., Metairie, LA 70001. And oh yes, I was just kidding about New Orleans. It's a great town, and if you haven't walked down Bourbon Street on a Saturday night, you've got an experience coming. That walk alone is worth the price of the whole trip.

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You think it's all under control. You think we're heading for a long-term decline in interest rates. Then digest this clip from the *National Taxpayers Union*, 325 Penn. Ave., SE., Washington D.C. 20003.

Government spending will top $1 trillion in 1981 for the first time in U.S. history according to Tax Foundation projections. All units of government—federal, state, and local—will spend an estimated $1.07 trillion in the current fiscal year, say Foundation economists, up from $942 billion in fiscal 1980.

That means that government will be spending $4,678 for each man, woman, and child in the United States, or $13,211 per U.S. household. Federal expenditures will continue to claim the lion's share of all outlays, a total of $710 billion—two thirds of all government spending.

Federal spending, including grants to state and local governments, is also growing faster than spending from funds raised by states and localities, which will total an estimated $358 billion in fiscal 1981.

Since 1975, federal spending has grown by 109 percent, while state/local spending has increased by 63 percent. Long-term trends show a relentless escalation of government spending at all levels.

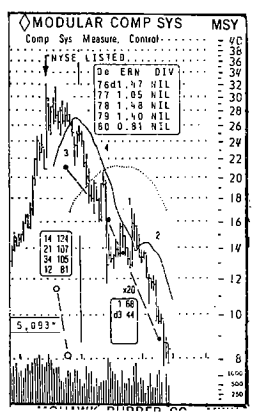
GOODBYE MIKE: A.M. ("Mike") Shumate was a true student of Dow Theory and the market. He and Sparta Fritz in the 1940's wrote a book entitled, *"Making the Dow Theory Work."* The book was published by *Barron's. Barron's* gave me permission in 1960 to reprint this book. I did so and sold thousands of copies (I have no more now). Last week Mike's son called me to tell me that "Dad died."

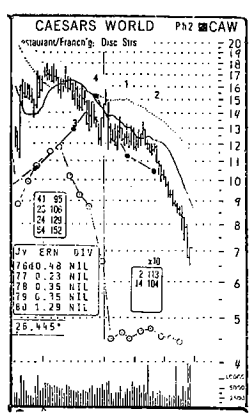
Mike was a friend and teacher, and for 20 years Mike and I corresponded and occasionally saw each other. Mike was one of the humblest and most intelligent men I've known. When Mike made a comment or wrote me a letter about the market, I always studied it with care. So now another true student of the markets is gone – one with almost half a century of experience. There aren't many of them, and I find myself with fewer and fewer of my old advisors and buddies around (I particularly miss George Schaefer and Mike Shumate). Well, this is a lonely writing business, and as they say, sooner or later you have to develop the strength to stand alone. One by one, the ropes are cut – until finally you find yourself holding up others.

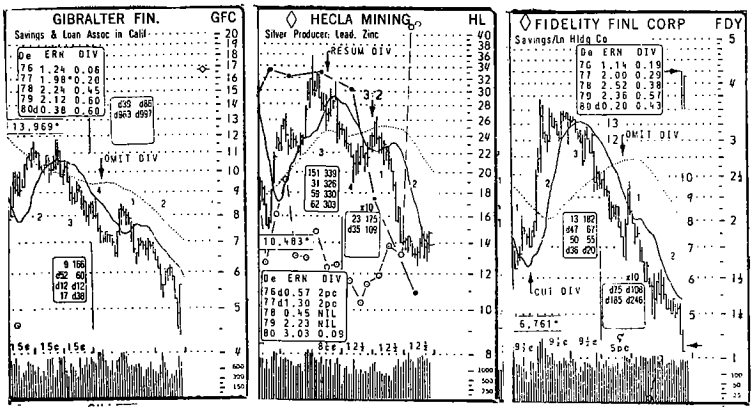
MONEY: During the fourth quarter the Treasury will have to raise $33 billion in new money, the biggest fourth quarter requirements in its history. For the next 6 months Treasury new money requirements will be between $60 and $70 billion. Under these conditions, any decline in interest rates will be just a breather, a rest preparatory to new highs in rates. Prognosis: stay in the T-bills. Nothing has changed, nothing has been solved, nothing has been "fixed." Spending as usual is the order of the day, and the trillion dollar Government debt is finally here.

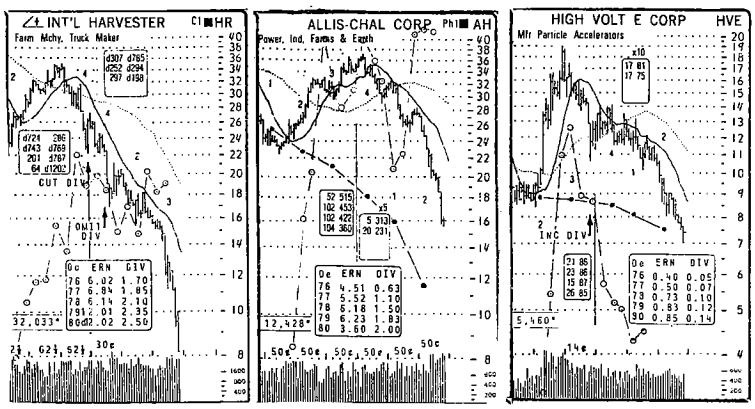
Following a breather, I expect a new push in interest rates as corporations enter the market to raise money in order to service their booming debt. An early omen: *Dome Petroleum* (which owes $4.7 billion Canadian) is now rumored to be borrowing to pay the interest on its debt. This may well be the wave of the future in corporate horror stories.

MARK OF THE BEAR: Not everyone has access to charts, and for their edification I'm including here a selection of "bear market beauties," all from the NYSE, stocks that have been doing swan dives over the past six months or so. These charts comprise a good argument against riding out a primary bear market, and you might cut 'em out for your kids as a form of advanced financial education. Many stocks are just now forming major tops, but others (including those pictured here) are in various states of bear market collapse. Charts are courtesy of *Quote Digest*, PO Box 213, Wichita, KS 67201.









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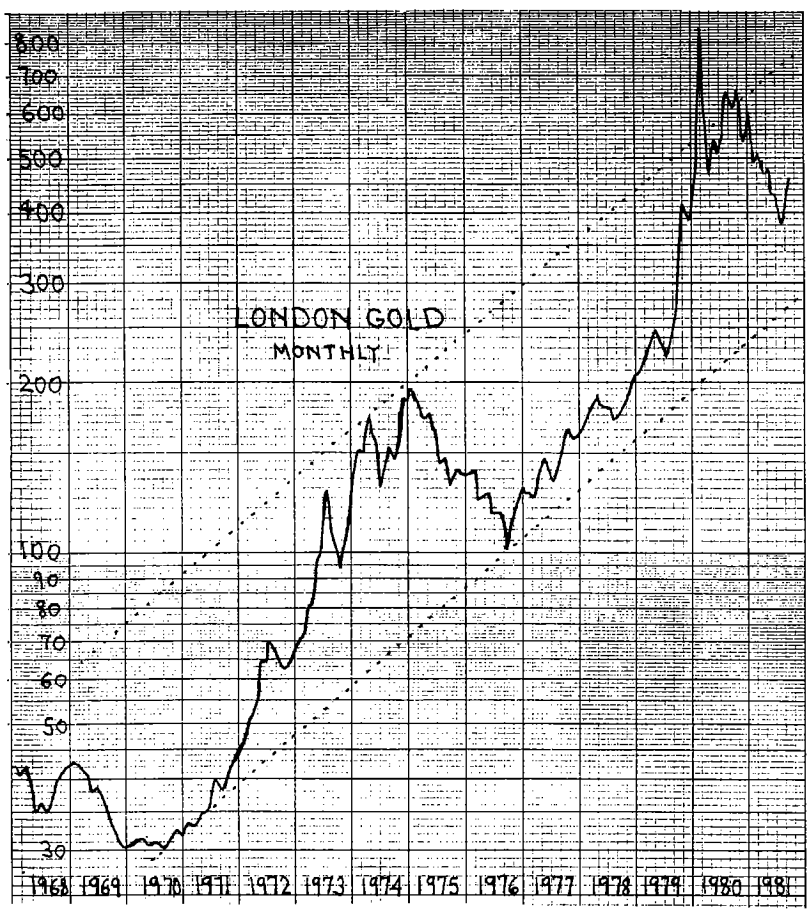

GOLD SILVER: The Government announced again that it is going to sell millions of ounces of silver. This repeat announcement provided the excuse for a $1.12 dump in silver (Sept. 17) and a sympathetic drop in gold. Why is Government selling silver at today's price of under $10? Why didn't they sell silver at $30 or $40 or $50? My only answer to this is "Who the hell knows?" And I suppose that answer would fit most things our Government does.

I am asked whether it would be bullish or bearish if the US goes back to a fixed dollar-gold relationship. It would be bearish for gold, since the Government would probably fix the price too low, and since thereafter there would be little or no change in the dollar price of gold. But I don't think the dollar can be tied to gold in any meaningful way until the dollar is rendered stable. Then by tying it to gold, they can make the dollar "as good as gold." But that (alas) is a long way off.

A long-term perspective of gold might be in order here. Therefore, I am showing my long-term monthly chart of bullion. Note that the 1980-81 cave-in took gold back to the middle of its long-term channel, an event that I predicted back in 1980. Nevertheless, the important thing is that the long-term trend of gold is still intact. This may seem like a minor thing to holders of spot gold, but in the future scheme of things it is not. A few years hence we may look at the 1980-81 action as simply a purge of the 1979-80 over-enthusiasm. Note that spike which formed during early-1980.

In the meantime, I continue to think that gold hit its low at 392. And I also think gold could mill about, backing and filling for quite a while before anything profitable, exciting or meaningful occurs for the yellow metal.

Gold momentum (13-week rate of change) hit 96.8 last week. This study will turn bullish with a momentum figure above 100. The 5-week moving average for gold is now 439, definitely above the 13-week MA which is 433. The 50-week MA is 485. On the moving average study, the intermediate term trend for gold is now bullish. If when the 13-week MA betters the 50-week MA, we will have a signal that the primary trend of gold is bullish.

LATE MARKET NOTES: The Dow has declined in 6 out of the past 7 weeks. It is more oversold now than at any time since 1974. But it should be remembered that some of the worst declines have occurred when the market has been heavily oversold. For instance, many analysts are pointing to the percentage of advisories that are now bearish (well over 50% at present). But this same percentage (over 50% bearish) prevailed for 19 consecutive weeks in 1974. So we have to give the bear time and breathing space in a primary bear market. a few weeks of bearishness isn't going to turn the tide..... As of September 18 the bear market was again reconfirmed when the Industrial and Transportation Averages plunged simultaneously to new lows.....So far, we have not seen "scared" (i.e., liquidating) volume on the downside. That should come in due time.....Low volume during a bear market decline usually means that no one is getting out, and that's bearish.